Supreme Court of the United States

OCTOBER TERM, 1946.

No. 1214

AMERICAN POWER & LIGHT COMPANY

AND

FLORIDA POWER & LIGHT COMPANY,
Petitioners,

against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT. BRIEF IN SUPPORT THEREOF.

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April 3, 1947.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

American Power & Light Company and Florida Power & Light Company pray that a writ of certiorari issue to the United States Circuit Court of Appeals for the First Circuit to review the decree of that Court entered in the above-entitled cause on December 9, 1946, affirming an order of the Securities and Exchange Commission (hereinafter referred to as the Commission), dated December 28, 1943, and an order of that Commission denying Petitioners' Application for Rehearing, dated January 12, 1944.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 24(a) of the Public Utility Holding Company Act of 1935 (49 Stat. 803, 834-5; 15 U.S.C. §79x(a)) and Section 240(a) of the Judicial Code, as amended (28 U.S.C. §347(a)).

The Opinions Below.

The opinion of the Circuit Court of Appeals for the First Circuit was rendered on December 9, 1946 and is reported at 158 F. (2d) 771. The opinion appears at R. 2002-2025 in Volume V.

The opinion of the Commission rendered December 28, 1943, the order of the same date, and the order denying the Petitioners' Application for Rehearing dated January 12, 1944, have not been officially reported. The portions of the order of the Commission which form the basis of this Petition appear at R. 102.

Statute Involved.

The statute involved is the Public Utility Holding Company Act of 1935 (49 Stat. 803, 15 U.S.C. §79), hereinafter referred to as the "Act". The portions of that Act which are directly involved are Sections 15(f) and 20(a) thereof (15 U.S.C. §79o(f) and §79t(a)).

Section 15(f) provides:

> "All accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records kept or required to be kept by persons subject to any provisions of this section shall be subject at any time and from time to time to such reasonable periodic, special, and other examinations by the Commission, or any member or representative thereof, as the Commission may prescribe. The Commission, after notice and opportunity for hearing, may prescribe the account or accounts in which particular outlays, receipts, and other transactions shall be entered, charged, or credited and the manner in which such entry, charge, or credit shall

be made, and may require an entry to be modified or supplemented so as properly to show the cost of any asset or any other cost."

Section 20(a) provides:

"The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this chapter, including rules and regulations defining accounting, technical, and trade terms used in this chapter. Among other things, the Commission shall have authority, *for the purposes of this chapter,* to prescribe the form or forms in which information required in any statement, declaration, application, report, or other document filed with the Commission shall be set forth, the items or details to be shown in balance sheets, profit and loss statements, and surplus accounts, the manner in which the cost of all assets, whenever determinable, shall be shown in regard to such statements, declarations, applications, reports, and other documents filed with the Commission, or accounts required to be kept by the rules, regulations, or orders of the Commission, and the methods to be followed in the keeping of accounts and cost-accounting procedures and the preparation of reports, in the segregation and allocation of costs, in the determination of liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the keeping or preparation, where the Commission deems it necessary or appropriate, of separate or consolidated balance sheets or profit and loss statements for any companies in the same holding company system."

Summary Statement.

American Power & Light Company (hereinafter called "American"), a Maine corporation, registered as a holding company under the Act in 1938.

Florida Power & Light Company (hereinafter called "Florida") is a Florida corporation.

American owns directly and indirectly practically all the common stocks and some other securities of 13 corporations, of which 11 are operating electric (and, in a few instances, gas) public utilities. American owns all the common stock of Florida. The Commission has ordered American to dispose of its holdings and to dissolve. *American Power & Light Co. and Electric Power & Light Corp.* v. *Securities and Exchange Commission,*—U.S. —; 91 L. Ed. (Adv. Op.) 89.

Florida is an operating electric and gas utility conducting its business solely in the State of Florida.

The Commission by its order of July 10, 1941, which initiated the proceedings before the Commission, raised issues which included "the necessity for stopping dividends on preferred and common stocks held by American * * *."

In the proceedings below, the Commission made a finding that the sum of $1,815,655 of Florida's plant account represented profits (principally a 4% construction charge) realized by affiliates (other than American) on engineering and construction services rendered to Florida (R. 108-109) and, without regard for the demonstrated reasonableness of the payments, ordered the elimination from Florida's plant account of the costs represented by the payments by charge to earned surplus (R. 99). The items going to make up the $1,815,655 are hereinafter sometimes referred to as the Account 107 items.

The Commission also made a finding that the actual arm's length cost of Florida's assets to it might ultimately be found to be as much as $10,500,000 in excess of the original cost of those assets to the person who first placed them in public service (R. 93) and, without determining what the actual costs represented, ordered Florida to prepare for their ultimate expurgation from Florida's books, by removing annually from earned surplus to a contingency reserve, the sum of $700,000 (R. 102). The items going to make up the $10,500,000 are hereinafter sometimes called the Account

100.5 items. Since three years have elapsed from the effective date of this part of the order, its effect has been to remove from surplus, otherwise available to American as dividends, the sum of $2,100,000.

Petitioners state factually, not as argument, that there is no evidence in the record to the effect that any part of the $10,500,000 represents "fictitious or paper increment" or that the sum does not represent "an investment which the accounting company has made in assets of continuing value" or that the assets thereby represented have ceased to exist or have been retired.

The record does show that the entire sum is the excess of actual arm's length cost over "original cost".

American filed its petition in the Circuit Court of Appeals for the First Circuit and Florida filed its Petition for Review of these orders by the United States Circuit Court of Appeals for the Fifth Circuit.

On June 19, 1944, the Circuit Court of Appeals for the First Circuit issued its opinion directing that Petitioner's Petition for Review be dismissed upon the ground that the Petitioner, in effect, was not a "person or party aggrieved" within the meaning of Section 24(a) of the Act. 143 F. (2d) 250. Upon certiorari, this Court on June 4, 1945, reversed (325 U. S. 385), holding that the order now before this Court (p. 389) "* * * has a direct adverse effect on American as a stockholder entitled to dividends * * *."

On December 9, 1946, the Court below affirmed, 158 F. (2d) 771, both portions of the Commission's Order, the Court holding (1) as to the Account 100.5 items, that as no definitive order of disposition was involved, preliminary findings (indicating a probability that the Commission would in the future require that a substantial portion of the items be written off against income or operating expense account) were sufficient to warrant the appropriations from surplus to a contingency reserve, and (2) as to the Account

107 items, that without regard to the rule of reasonableness, and under a cost system of accounting, costs giving rise to profits in transactions between affiliates must be eliminated from the books by a charge to earned surplus.

It must be recognized that there would be no point at all in requiring the removal of these sums from earned surplus to a contingency reserve unless the Commission were empowered to cause the restatement of the assets to reflect "original cost" instead of actual cost.

Because the Commission's Order and the opinion of the Court below are directed to the two separate items of account, the remainder of this Petition is so separately directed.

The Questions Presented.

As to the Account 100.5 Items:

1. Is the order of the Commission, having a direct adverse effect on the stockholder of a corporation by requiring that the corporation make provision, by charges against surplus, to write off and eliminate from its books items representing actual arm's length cost, in the absence of findings based on substantial evidence that such items are improperly in the asset accounts, valid under the Constitution of the United States?

2. Is the Commission empowered by the Act to require a corporation to remove from its earned surplus amounts otherwise available to its stockholders as dividends, for the ultimate purpose of reforming the asset accounts to substitute the cost of those assets to some prior owner for and instead of the actual cost of those assets to the corporation itself?

As to the Account 107 Items:

1. Is the order, based on the theory of "no-profits between affiliates", upon a record which demonstrates (a) that the profits were fair and reasonable, (b) that the

profits were never received by the stockholder adversely affected and (c) that the stockholder and the recipient of the profits were owned by different groups of investors, valid under the Fifth Amendment to the Constitution of the United States?

2. Is the Commission empowered by the Act to require a corporation to remove amounts otherwise available to its stockholders as dividends from its earned surplus, for the purpose of eliminating from the asset accounts costs repreenting reasonable payment for services received, merely because the recipient was affiliated with the stockholder?

Specification of Errors to be Urged.

1. As to the opinion of the Court below in so far as it related to the Account 100.5 items, the Court erred in affirming the Commission's order

(a) because the Opinion ignores the fact that the order in its present form (not some future definitive order based on evidence and findings), "has a direct adverse effect upon American as a stockholder entitled to dividends", 325 U. S. 385, 389;

(b) because the Opinion ignores the fact that the Order was based on the Commission's concept of possibilities and probabilities, as distinguished from evidence and findings;

(c) because the Order was issued in the absence of legislative authority or direction to require Florida to alter its earned surplus account for the sole and unauthorized purpose of bringing about ultimate substitution of "original cost" for actual cost in its asset accounts;

(d) because the Order has the effect, arbitrarily and unconstitutionally, of diverting from the stockholder (which may soon be public investors at large) income

and surplus lawfully earned and available for dividends, to the unauthorized purpose of recasting the asset accounts; and

(e) because the Order imposes such a measure of just plain bad accounting,—the kind that falsifies and does not reflect the facts,—that it is arbitrary and capricious.

2. As to the Opinion of the Court below in so far as it related to the Account 107 items, the Court erred in affirming the Commission's Order

(a) because the Order is based on the erroneous conclusion that the rule of the "licensee" cases under the Federal Power Act, (involving license contracts) as well as a legislative direction to set "recapture" prices at "actual legitimate original cost" and illustrated by *Pennsylvania Power & Light Company* v. *Federal Power Commission*, 139 Fed. 2d 445, certiorari denied 321 U.S. 798, is applicable to the facts in this case;

(b) because the Order is based on the erroneous conclusion that "profits between affiliates are illegitimate items of cost" without regard to the degree of affiliation and the reasonableness of the payments;

(c) because there is no legislative authority or direction to the effect that solely because costs were incurred in transactions between affiliates, they must be denied accounting recognition;

(d) because the record here shows the major part of the Account 107 amounts represented payments to affiliates which were proportionately less than actual payments for identical construction services made contemporaneously to non-affiliated interests and were less than the scale of payments adopted by the Association of General Contractors and because of the absence of any showing that there was any fraud or overreaching in connection with the transactions;

(e) because it has the arbitrary effect of making the stockholder pay sums to Florida which the stockholder never received and which in fact were paid to companies which are owned by investors different from the owners of American;

(f) because it is predicated upon the false assumption, contradicted by the record, that American, and the affiliated companies to which the payments were made, were the same corporate entities;

(g) because of the absence of any requirement of the Uniform System of Accounts, itself promulgated by the Commission, that payments in transactions between affiliates, however reasonable, be denied recognition as cost.

3. The Court erred in affirming the portions of the Order here attacked because upon the facts in this case the Commission exceeded its statutory authority and deprived Petitioners of property in contravention of Amendment V to the Federal Constitution. Furthermore, Sections 15(f) and 20(a) of the Act are not authorized as regulations of commerce or as being on the subject of bankruptcies, nor for the establishment of post offices or post roads. Sections 15(f) and 20(a) invade powers reserved to the states by Amendment X to the Constitution.

4. The Court below erred in denying Petitioners' petition for rehearing.

Reasons Relied On for Grant of Writ.

(1) Whether, under the Act here involved, a corporation can be required, to the detriment of its stockholders, to make provision for restating its asset accounts to reflect, instead of the actual cost of those assets to it, the yet-to-be-determined cost thereof to some prior owner, is an im-

portant Federal question which has not been, but ought to be, settled by this Court.

(2) The Court below, in affirming the Order of the Commission without requiring clear and definitive administrative findings as a basis for the substantial action required by the Order, probably failed to give effect to the holding of this Court (325 U.S. 385), that the Order in its present form had a direct adverse effect on American, one of the Petitioners herein and probably departs from the principles illustrated by *Colorado-Wyoming Gas Company* v. *Federal Power Commission*, 324 U.S. 626, as to the necessity for clear and definite administrative findings.

(3) The Opinion below is probably in conflict with *American Telephone & Telegraph Company* v. *United States*, 299 U.S. 232, in that here the administrative order actually does require substantial restatement of accounts in the absence of supporting evidence and findings but upon an expectation or speculation that in the future evidence will be adduced and findings made which will support such restatement.

(4) Whether or not, under the Act here involved, a rule of absolute non-recognition of profits in dealings between affiliated entities is to be applied, is likewise an important federal question, as such a rule appears to be in conflict with previous decisions of this and many other courts and with the general practice of departments of federal government and business generally.

(5) A real question of present and current deprivation of property without due process of law in violation of the Fifth Amendment to the Federal Constitution is presented, inasmuch as Petitioners are sustaining direct adverse effects of the administration action, taken in administrative expectation of, but without basis either in existing evidence or in clear and definite findings

WHEREFORE, for the reasons stated above and discussed more fully in the annexed brief, your Petitioners pray that a writ of certiorari be issued out of and under the seal of this honorable Court, directed to the United States Circuit Court of Appeals for the First Circuit, to the end that the above cause may be certified to and reviewed and determined by this Court and that the judgment of said Circuit Court of Appeals in the above-entitled cause may be reviewed by this Court, and your Petitioners pray for such other and further relief as this Court may deem just and proper.

Respectfully submitted,

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FLORIDA POWER & LIGHT COMPANY.

April 3, 1947.

Supreme Court of the United States

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No.....

AMERICAN POWER & LIGHT COMPANY

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BRIEF IN SUPPORT OF PETITION

A principal uncertainty about the correctness of the Opinion below is that it assumes that future administrative action will be taken after a future hearing and upon evidence which may or may not be adduced to support such future action.

In the meantime, the Petitioners sustain adverse effects which may never be remedied. Particularly, American shortly will lose its status as stockholder of Florida under the impact of the act. *American Power & Light Co. and Electric Power & Light Corp.* v. *Securities and Exchange Commission,* — U.S. —; 91 L. Ed. (Adv. Op.) 89.

The Opinion below assumes the legality of such action, although in no previous proceeding has this Court passed upon:

(1) the question of the authority of the Commission, under the Act here involved which differs materially from other regulatory acts, to impose "original cost" accounting; and

(2) the question of the authority of an administrative tribunal to require substantial alteration of rights in anticipation of future administrative action, the evidentiary basis for which admittedly has not been laid.

The real basis of the Opinion below lies in the assumption that, as to the Account 100.5 items, so long as no final disposition of cost accounts has been ordered, the parties can be required to proceed as if such final disposition had been determined adversely to the contentions of the Petitioners on all points of fact and law. The effect is to apply the assumption to remove from Florida's surplus millions of dollars and withhold them from American when American otherwise, under the facts and laws of the State of Florida, is entitled to receive them as they become available.

In other words, the order amounts to a final determination, at this stage of the proceedings, that in the years 1944, 1945, 1946 and 1947, American must forego dividends in the amount of $2,800,000, or entirely, if it should cease to be a stockholder before the matter is finally settled through the application of due process of law.

The Court below thought the Commission's findings "were sufficiently within the spirit of the doctrine of the *American Telephone & Telegraph* case to support the order requiring a contingency reserve to be accumulated to offset probable write-offs of the amounts eventually to be classified in Account 100.5." But the administrative facts in the *American Telephone & Telegraph* case were that the Company was not required to remove any portion of its surplus

to any reserve. The whole machinery of administrative action came to a standstill pending final administrative determination after investigation of all the facts.

Even the Uniform System of Accounts prescribed by the Commission itself makes no provision for any such interim effect on substantive rights.

In any event, it cannot be gainsaid that this aspect of the case is one of first impression in this Court and requires resolution.

As to the Account 107 items, this Court has never applied the rule of absolute non-recognition of profits in transactions among affiliates under this or any other Act. The question has never been squarely before the Court, particularly under this Act. It was not squarely before the Court in *United States* v. *New York Telephone Company*, 326 U. S. 638, where the Court held that upon the basis of a full hearing on the precise question of the validity of the items as cost, it had been finally found that the transaction involved nothing but a bare transfer of title to property from one affiliate to another, the creation of no new thing of value and no change in function of the property.

This application of the rule of absolute non-recognition is confusing to the whole business economy.

This Court knows that the Bureau of Internal Revenue gives full recognition to costs incurred in inter-affiliate transactions in absence of a showing of fraud or overreaching.

Similarly, in connection with the renegotiation of War and Navy Department contracts, the regulations provide as to dealings between affiliates that "The net cost of such purchases should not be greater than it would have been had they been made from others".

The confusion introduced into the general economy by application of the absolute non-recognition doctrine should be removed by the determination of this Court.

Conclusion

It is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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WILL M. PRESTON,
Counsel for Petitioner,
FLORIDA POWER & LIGHT COMPANY.

April 3, 1947.

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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 1214

AMERICAN POWER & LIGHT COMPANY AND FLORIDA POWER & LIGHT COMPANY, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the First Circuit (R. 2002–2025) affirming an order of the Securities and Exchange Commission, issued under the Public Utility Holding Company Act of 1935 (49 Stat. 803, 15 U. S. C. § 79), is reported in 158 F. 2d 771. The findings, opinion and order of the Commission in this matter, dated December 28, 1943, and the order denying petitioner's application for rehearing, dated January 12, 1944

(R. 57–103, 109–110), have not been officially reported, but are contained in Holding Company Act releases 4791 and 4824.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 9, 1946, and rehearing was denied on January 8, 1947 (R. 2025).

The jurisdiction of this Court is invoked under Section 24 (a) of the Public Utility Holding Company Act of 1935 (49 Stat. 803, 834–35; 15 U. S. C. § 79 x (a)) and Section 240 (a) of the Judicial Code, as amended (28 U. S. C. § 347 (a)).

QUESTIONS PRESENTED

Did the Commission, in passing on a proposed public offering of securities by a registered holding company's subsidiary under the Public Utility Holding Company Act of 1935, properly require the subsidiary:

1. To eliminate from its plant accounts and charge to earned surplus $1,815,655 which the Commission found represented intrasystem profits paid by the subsidiary to an affiliated service company in the guise of construction and engineering fees;

2. To create a contingency reserve by annual appropriations from earned surplus of $700,000, so that over a period of fifteen years provision will be made for the possible disposition of $10,500,000 estimated by the Commission and not

disputed by petitioners to be approximately the amount of the excesses of unamortized actual cost (not including writeups) of purchased utility operating properties over the original cost of such properties to the person first devoting them to the public use, pending final determination by the Commission of the exact amount and final disposition to be made of such excesses?

STATUTE INVOLVED

The applicable provisions of the Public Utility Holding Company Act of 1935 are set forth in the Appendix.

STATEMENT

The Electric Bond and Share Company[1] holding company system, of which petitioners are constituent companies, has been examined by this Court in at least two other cases, *Electric Bond and Share Co.* v. *Securities and Exchange Commission,* 303 U. S. 419, and *American Power and Light Co.* v. *Securities and Exchange Commission,* 329 U. S. 90. In the latter case reference was made to the fact that the Commission had found that the book figures of various operating companies of the system required revision.[2] The present case is concerned with the adjustments required by

[1] Florida Power and Light Company and American Power and Light Company are hereinafter referred to respectively as "Florida" and "American", and Electric Bond and Share Company is referred to as "Bond and Share".

[2] *American Power and Light Co.* v. *Securities and Exchange Commission*, 329 U. S. 90.

the Commission in the book figures of Florida, an operating subsidiary of American, a holding company registered under the Holding Company Act, which is in turn a subsidiary of Bond and Share, also a registered holding company.

Florida was organized in December, 1925, and represented a consolidation of various electric and gas utilities and related companies located in the state of Florida, which had been acquired by American in 1924–1925. This was at the time of the historic Florida real estate boom, which lasted from 1923 to 1926. As soon as control of each company was obtained Bond and Share employees were placed in active charge as officers and directors, and the operating company was made to enter into a service contract with Bond and Share by which operations were controlled in detail by Bond and Share (R. 855, 869–884) and the Bond and Share "fee" system was applied to an extensive program of construction which was undertaken (R. 544, 1070).

The books of Florida's predecessor companies contained an aggregate of $3,314,740 in their plant accounts in excess of cost to the predecessor companies, and American paid a total of $2,302,-363 in excess of predecessor book cost for these properties (R. 93, 953–954, 1069, 1385, 1389). The total of these sums, $5,617,103, was included on the books of Florida at the time Florida was

organized.[3] After its organization Florida continued to purchase and construct additional properties on a large scale until 1930 (R. 1070). By then, the purchases resulted in an additional $4,881,014 excess over the original cost of the properties appearing in Florida's accounts (R. 1385–1389). While there has not been a definitive determination thereof by the Commission, it is not disputed that a total of approximately $10,500,000 in the plant account represents an excess over the original cost of the properties (R. 153, 276–278, 2005). In addition, the Commission found that Florida added to its plant account $1,815,655, which represented profits included in fees paid to affiliated companies for construction and engineering services (R. 92). The items making up the foregoing sums were admittedly not depreciated on Florida's books (R. 2017),[4]

[3] The Commission found that Florida's plant account on its opening balance sheet also contained approximately $32,000,000 in excess of American's cost of the property (R. 65). Substantially all of this sum has been removed from Florida's books, $27,615,044 since the institution of this proceeding and $3,675,000 just prior thereto (R. 68, 1368).

[4] As a matter of bookkeeping, for reasons primarily relating to the depreciable tax base allowed by the United States Treasury Department for income tax depreciation purposes, Florida carried all or substantially all of its property on its detailed property ledger at approximately the original cost of the physical property, and the surplus over original cost was carried in a lump sum "balloon" account, which was not depreciated (R. 947–51).

remaining a capital asset at the time the Commission's order was entered.

Pursuant to a notice and order for hearing issued July 10, 1941, an extensive inquiry was conducted into Florida's capital structure, and petitioners ultimately submitted a plan involving the issuance of new securities to bring that structure into conformity with the standards of the Public Utility Holding Company Act. The Commission approved the proposed financing and the proposed accounting adjustments, but made two additional accounting requirements, which are the subject of this review. First, the Commission, having found that $1,815,655 of the plant account represented profit to affiliates, ordered this sum to be eliminated by a charge to earned surplus. Secondly, pending the final determination of the nature and precise amount of the remaining items in Florida's plant account in excess of original cost, which determination was to be based on an original cost study Florida had previously been required to make, the Commission ordered the establishment of a contingency reserve by annual charges to earned surplus of $700,000 so that all or any portion of the amount of approximately $10,500,000 in excess of original cost which might be required to be eliminated from Florida's plant account over a fifteen year period from the date of the order, could be charged to the contingency reserve so accumulated.

The order of the Commission was affirmed by the Circuit Court of Appeals (R. 2025).

ARGUMENT

1. The petitioners ask this Court to bring up for review the affirmance of the Commission's requirement that Florida eliminate from its plant accounts, by charge to earned surplus, the $1,815,655 of profits paid to affiliated service companies under the Bond and Share "fee" system. In so doing, petitioners seek to reopen a question settled by an unbroken line of decisions. *United States* v. *New York Telephone Company,* 326 U. S. 638;[5] *Colorado Interstate Gas Company* v. *Federal Power Commission,* 324 U. S. 581, 606–608; *Alabama Power Company* v. *Federal Power Commission,* 134 F. 2d 602, 609 (C. C. A. 5); *Puget*

[5] In the *New York Telephone Company* case, the company conceded the Federal Communication Commission's powers with respect to an affiliate's profits "remaining in appellee's property accounts" and questioned only the commission's power to direct readjustment of depreciation accounts in order to eliminate underdepreciation resulting from profits to an affiliate previously included in plant accounts. 326 U. S. at 648. Furthermore, the Court's opinion in that case disposes of the present petitioners' attempt to invoke the decision in *American Telephone & Telegraph Company* v. *United States*, 299 U. S. 232, for the Court points out that the Commission's finding in the *New York Telephone Company* case that the amount was a profit to an affiliate, brought its order within the reservation of the *American Telephone & Telegraph Company* opinion as involving, not a true investment, but only a "fictitious or paper increment." 326 U. S. at 652–654.

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Sound Power & Light Company v. *Federal Power Commission,* 137 F. 2d 701, 703 (App. D. C.); *Niagara Falls Power Company* v. *Federal Power Commission,* 137 F. 2d 787, 792–795 (C. C. A. 2), certiorari denied, 320 U. S. 792; *Pennsylvania Power & Light Company* v. *Federal Power Commission,* 139 F. 2d 445, 450 (C. C. A. 3), certiorari denied, 321 U. S. 798; see also *Northwestern Electric Company* v. *Federal Power Commission,* 321 U. S. 119. As this Court pointed out in the *Colorado Interstate Gas Company* case (324 U. S. 581, 607–608), the end result of a transfer from one subsidiary of a holding company to another at an intercompany profit is a write-up or inflation of capital assets, and it was the prevalence of that practice in the holding company field which gave rise to an insistent demand for federal regulation.

Petitioners' contention that the no-profits-to-affiliates rule may not be applied where the record contains evidence tending to show the fairness or reasonableness of the profit, and petitioners' reference to fields of law outside the regulation of utilities, in which the legality of reasonable profits to affiliates is recognized (Petition, pp. 14–15), merely repeat the arguments of another Bond and Share company, petitioner in the *Pennsylvania Power & Light Company* case, *supra,* in that company's unsuccessful attempt to bring the same question before this Court. See the petition for certiorari, No. 769, October Term, 1943, pp. 6, 9, denied, 321 U. S. 798.

That case also completely answers petitioners' contention that the required elimination of the $1,815,655 profits to affiliates is not properly supported by the findings and record.[6] The Commission, upon its consideration of the record in this case, which included substantially everything that was in the record underlying the Federal Power Commission's order affirmed in the *Pennsylvania Power & Light Company* case, *supra*,[7] agreed with the administrative conclusion and findings in that case and made similar findings (R. 86–93). That case involved the same controlling factual situation and an administrative order the relevant part of which was similar to the part of the present order now under consideration. The opinion of the Circuit Court of Appeals for the Third Circuit discloses that that court had carefully considered the support for the Federal Power Commission's determination in that case. The consistent decisions of two circuit courts of appeals, upholding the sufficiency of substantially the same record on the principal factual questions and the adequacy of similar findings to support similar accounting requirements, is persuasive that no question is now presented meriting review by this Court, par-

[6] This contention is apparently applicable to that part of the Commission's order as well as the part hereinafter discussed. See the second and third reasons relied on for grant of writ. Petition, p. 10.

[7] See R. 1391–1589, 1681–1961. See, in addition to the record from the Federal Power Commission proceeding, R. 228–261, 415–425, 847–851, 869–884, 872–883.

ticularly where certiorari has already been denied in one of the cases (321 U. S. 798).

Although petitioners question the application of the non-profits-to-affiliates rule "under the Act here involved,"[8] they do not point to any distinction between Sections 15 (a), (f), (i), and 20 (a) of the Public Utility Holding Company Act (*infra*, pp. 20–22) and Sections 208 and 301 of the Federal Power Act (41 Stat. 1063, as amended, 49 Stat. 848, 16 U. S. C. 824g, 825), or Sections 220 (a), (c), (g) of the Communications Act of 1934 (48 Stat. 1064, 47 U. S. C. 220 (a), (c), (g)), under which the orders involved in the above cited decisions were issued. A comparison of the provisions of the three statutes indicates the complete absence of any material difference relevant here.

Petitioners attack upon the constitutionality of the foregoing provisions[9] is clearly without merit. As this Court has reiterated, the regulation of public utility holding companies is a valid exercise of the Congressional power over interstate commerce. *Electric Bond and Share Company* v. *Securities and Exchange Commission*, 303 U. S. 419; *North American Company* v. *Securities and Exchange Commission*, 327 U. S. 686; *American Power & Light Company* v. *Securities and Exchange Commission*, 329 U. S. 90. Florida is a subsidiary of American and of Bond and Share, and

[8] See the fourth reason relied on for grant of writ, Petition, p. 10.

[9] See the third specification of errors, Petition, p. 9.

is one of the instrumentalities through which those holding companies have conducted and continue to conduct their interstate transactions. Through interstate control those holding companies have caused the entry upon the books of Florida of the write-ups and other excesses over original cost dealt with by the Commission's order and caused also the distribution by Florida of its securities which the Commission's order passed on under Section 7 as preliminary to a public offering of these securities through the facilities of interstate commerce. It is such interstate activities of the Bond and Share System, of which Florida is a part, which bring Florida's accounts within the reach of the commerce power.

Petitioners' contentions as to American's rights to dividends as common stockholder in Florida and its alleged deprivation of property in contravention of the Fifth Amendment are disposed of by the decision in the *Northwestern Electric Company* case, *supra,* where similar contentions, advanced upon behalf of the same American Power & Light Company, petitioner there, as a common stockholder in Northwestern Electric Company (see petitioners' brief, No. 195, October Term, 1943, pp. 6–7, 13–14, 43–54), were overruled by the Court. 321 U. S. at 125.[10]

[10] American has recognized that its rights as a stockholder were similarly involved in the *Northwestern* case. *American Power & Light Company* v. *Securities and Exchange Commission*, 325 U. S. 385, No. 470, October Term, 1944, Petitioners' Brief, p. 10, note 1.

The scope of the ruling in that case is not limited by this Court's subsequent decision in *American Power & Light Company* v. *Securities and Exchange Commission,* 325 U. S. 385. For there this Court, merely holding that a parent corporation was a "person aggrieved" within the meaning of Section 24 (a) of the Public Utility Holding Company Act by an order directed to its subsidiary's accounts which might affect its right to dividends so that it may challenge the validity of that order, did not pass on the merits of that challenge.

A similar order in the *Northwestern* case was held to present "only a question of proper accounting" as to which the Court was "not called upon to make any decision as to the ability of the company legally to declare and pay dividends." 321 U. S. at 123, 125.[11] See also *Norfolk and Western Railway Company* v. *United States,* 287 U. S. 134, 141, and *Kansas City Southern Railway Company* v. *United States,* 231 U. S. 423, 453, where the Court, speaking of the regulated companies' preferred stockholders, said: "Supposing, however, that the enforcement of the accounting system does require them to forego their current

[11] The letter from the Chairman of the Securities and Exchange Commission, printed as Appendix D to the Federal Power Commission brief in the *Northwestern* case, described the possible effect of the accounting order there involved upon Securities and Exchange Commission control over dividends under Section 12 (c) (at pp. 103–105).

dividends, we do not concede that this amounts to an unlawful taking of their property."

2. As we have seen, page 5, *supra*, it is not contested that the difference between the cost to Florida of its properties (after elimination of intra-system profits) and the original cost of the properties is approximately $10,500,000, all of which is contained in Florida's plant account. The Commission did not order the immediate elimination of Account 100.5 items, but directed the accumulation of a reserve therefor at the rate of one-fifteenth of the total sum per year. Definitive disposition of these items will be made after the Commission has considered their nature as disclosed by the original cost study being conducted by Florida, and further opportunity to review the determination will be afforded at that time.[12] In considering the narrow issue of the propriety of the Commission's action it should be emphasized that the Commission entered its order at the same time it granted Florida authority to make a public offering of securities. The order, directing the establishment of a contingency reserve against a future order likely to require the elimination of these items, does no more than prudent accounting requires.

[12] At the time of the accounting directions under review Florida had not completed its original cost study for submission to the Commission. This study was submitted to the Commission only this year, but additional information has been requested. It is likely that the entire study will be completed within a year.

As the Commission stated (R. 96):

> * * * since all present indications are that there will be approximately $10,500,000 of * * * acquisition adjustments ultimately to be disposed of, conservative accounting requires that the company should begin now to make provisions for such disposition.

The Commission's conclusion that such an amount may be required to be disposed of is fully supported by the reasons it adduces and the undisputed facts. Each item making up this excess over original cost must ultimately be determined to be one of two things: cost of acquiring tangibles or cost of acquiring intangibles. If and insofar as the items may be determined to be tangibles, the record shows that they had been acquired from 15 to 20 years previously, were not new when acquired, and therefore have either already been retired from service or in all likelihood will be retired during the 15-year period in which the reserve is to be accumulated (R. 815–816, 948, 1070).[13] Furthermore, the Commission found that Florida had made no provision in its depreciation reserves for these amounts, depreciation having been computed on original cost only;[14] admittedly Florida had not

[13] The average life of steam-electric property is 31 years. U. S. Treasury Department, Bureau of Internal Revenue, Bulletin "F", revised January, 1942, p. 61. This document was contained in the record before the Commission (Tr. Doc. No. 75).

[14] See footnote 3, *supra*, p. 5.

made any charge to the depreciation reserve upon any retirement of any such tangibles (R. 2017).

If and insofar as this $10,500,000 excess over original cost represented intangibles, the Commission stated that it constituted payment for expected earnings which prudent accounting would not permit to continue indefinitely in the plant accounts. As the court below pointed out (R. 2018):

> The property that American transferred to Florida was acquired during the height of the Florida real estate boom and the major portion of the subsequent purchases of Florida were made prior to 1930. This was an era of inflated values and speculation. Prices at that time reflected expectancies of continued "prosperity."

Clearly the Commission was warranted in finding that intangibles of this nature would have to be amortized over a reasonable period of years. Conclusions similar to that of the Commission, and similar requirements for disposition of such intangibles, have repeatedly been affirmed. *California Oregon Power Company* v. *Federal Power Commission*, 150 F. 2d 25 (C. C. A. 9), certiorari denied, 326 U. S. 781; *Pacific Power & Light Company* v. *Federal Power Commission*, 141 F. 2d 602, 604–605 (C. C. A. 9); see also *Niagara Falls Power Company* v. *Federal Power Commission*, 137 F. 2d 787, 792–795 (C. C. A. 2).[15] In the

[15] In the *Niagara* case, the court, in an opinion by Judge L. Hand, said with respect to the price paid for a plant built

California Oregon Power Company case this Court denied certiorari on this very point.

Whether tangible or intangible, the items represented by this $10,500,000 excess will thus have been retired or have ceased to exist before the end of the 15-year period. This brings them within the reservation recognized in *American Telephone & Telegraph Company* v. *United States,* 299 U. S. 232, 241, where the Court upheld the accounting requirements there under review, upon the understanding that they permitted assets to be retained in capital accounts "until such assets cease to exist or are retired;" adding that "in accordance with paragraph (C) of account 100.4, provision will be made for their amortization."

In this case it is not, however, necessary to determine whether the Commission could require the excess to be so treated, but only whether it could require a contingency reserve to be built up to care for the possibility of a final order of such nature. Creation of such a reserve, whether pursuant to requirement of regulatory authority for the protection of investors, consumers, or the public generally, or by voluntary act of management to provide against a possible impairment of capital

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and in operation: "The only factor which determines its price is the 'prospective revenues' which it will produce. These may be larger or smaller than the 'original cost,' or the 'reproduction cost'; but that will not affect the purchase price, except as the scrap value of the plant serves as a 'floor,' or bottom price, below which the value will not go" (137 F. 2d at 794).

or to guard against declaration of dividends out of capital, is no more than a prudent provision for the possibility[16] of a subsequent order dealing with the disposition of the items, or, as the Commission found, "conservative accounting." Obviously it is not " 'so entirely at odds with fundamental principles of correct accounting' as to be the expression of a whim rather than an exercise of judgment." *United States* v. *New York Telephone Company,* 326 U. S. 638, 655.

The statutory and constitutional objections advanced in the petition, insofar as they pertain to the portion of the order involving this $10,500,000 excess over original cost, are disposed of by what has already been said with respect to similar objections to the portion involving the $1,815,655 of affiliates' profits. See pp. 10–13, *supra.* For it follows from what was said there that there is no such difference in the statutory or constitutional bases of the accounting jurisdiction of the Securities and Exchange Commission as to differentiate its powers with respect to ultimate disposition of the $10,500,000 excess from the accounting powers of the Federal Power Commission upheld in the *Pacific Power & Light* and *California Oregon Power* cases, *supra.* Hence petitioners' conten-

[16] The Twenty-Sixth Annual Report of the Federal Power Commission, Fiscal Year Ended June 30, 1946, on p. 46 shows that 138 electric utility companies have already disposed of or made a provision to dispose of a total of $347,656,454.11 of such excesses (other than write-ups) over original cost from their plant accounts.

tion that there is such a want of statutory or constitutional power in the Commission with respect to ultimate disposition as to make the possibility of such disposition too remote to constitute a real contingency is without merit.

CONCLUSION

The decision of the Court below is correct and no question is presented which would warrant further review by this Court. Accordingly, the petition for certiorari should be denied.

Respectfully submitted.

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MAY 1947.

APPENDIX A

Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. § 79 et seq.:

Section 1. * * *

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject

such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

(2) when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

* * * * *

SEC. 15. (a) Every registered holding company and every subsidiary company thereof shall make, keep, and preserve for such periods, such accounts, cost-accounting

procedures, correspondence, memoranda, papers, books, and other records as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers or for the enforcement of the provisions of this title or the rules, regulations, or orders thereunder.

* * * * *

(f) All accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records kept or required to be kept by persons subject to any provision of this section shall be subject at any time and from time to time to such reasonable periodic, special, and other examinations by the Commission, or any member or representative thereof, as the Commission may prescribe. The Commission, after notice and opportunity for hearing, may prescribe the account or accounts in which particular outlays, receipts, and other transactions shall be entered, charged, or credited and the manner in which such entry, charge, or credit shall be made, and may require an entry to be modified or supplemented so as properly to show the cost of any asset or any other cost.

* * * * *

(i) The Commission, by such rules and regulations as it deems necessary or appropriate in the public interest or for the protection of investors or consumers may prescribe for persons subject to the provisions of subsection (a), (b), (c), or (d) of this section uniform methods for keeping accounts required under any provision of this section, including, among other things, the manner in which the cost of all assets, whenever determinable, shall be shown, the methods of classifying and segregating accounts, and the manner in

which cost-accounting procedures shall be maintained.

* * * * *

SEC. 20. (a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this title, including rules and regulations defining accounting, technical, and trade terms used in this title. Among other things, the Commission shall have authority, for the purposes of this title, to prescribe the form or forms in which information required in any statement, declaration, application, report, or other document filed with the Commission shall be set forth, the items or details to be shown in balance sheets, profit and loss statements, and surplus accounts, the manner in which the cost of all assets, whenever determinable, shall be shown in regard to such statements, declarations, applications, reports, and other documents filed with the Commission, or accounts required to be kept by the rules, regulations, or orders of the Commission, and the methods to be followed in the keeping of accounts and cost-accounting procedures and the preparation of reports, in the segregation and allocation of costs, in the determination of liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the keeping or preparation, where the Commission deems it necessary or appropriate, of separate or consolidated balance sheets or profit and loss statements for any companies in the same holding-company system.

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